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**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of

Allocation of Costs Associated  
with Local Exchange Carrier  
Provision of Video Programming  
Service

CC Docket No. 96-112

To: The Commission

DOCKET FILE COPY ORIGINAL

**REPLY COMMENTS**

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Dated: June 12, 1996

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### SUMMARY

As it considers the various conflicting arguments regarding appropriate allocators, cost projections and network usage set forth in the comments filed in this proceeding, the Commission must stay focused on the goals set by Congress: to promote competition in the video services market; to encourage investment in new technologies; and to maximize consumer choice of services. Any cost allocation rules that hamper rather than foster the achievement of these goals will be inconsistent with the mandates of the 1996 Act.

The proposal by some parties of a 75 percent fixed allocation of loop costs to a LEC's nonregulated services is insupportable and will make LEC entry into the video services market economically prohibitive. Such a high allocation of costs to nonregulated services is not necessary to protect telephone ratepayers. Moreover, since it will make it difficult for LECs to employ integrated networks, a 75 percent fixed allocator will prevent telephone ratepayers from benefiting from the economies of scope of such a network.

The importance placed by some parties on the "administrative simplicity" of a fixed allocator is misplaced. While such a consideration is valid as long as it can be achieved consistently with the goals of the 1996 Act, those goals cannot be sacrificed merely in an attempt to obtain administrative simplicity.

The Commission's current cost allocation rules, and the fixed allocator used in the separations process, were prescribed only after a thorough public record on the subject was compiled. By contrast, in this proceeding the Commission is regulating in a vacuum. Any fixed allocator prescribed in this proceeding will do much to determine the course of development of the competitive services marketplace. The record in this accelerated proceeding is far too meager to justify prescribing a fixed allocator that will have such a substantial impact on the telecommunications market.

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**REPLY COMMENTS**

Puerto Rico Telephone Company ("PRTC"), by its attorneys and pursuant to Section 1.415 of the Commission's Rules, 47 C.F.R. § 1.415, submits these Reply Comments in response to the captioned Notice of Proposed Rulemaking ("NPRM") adopted and released on May 10, 1996.<sup>1/</sup>

**I. THE COMMISSION MUST NOT LOSE SIGHT IN THIS PROCEEDING OF THE GOALS SET BY CONGRESS IN THE 1996 ACT**

The Commission has recognized that Congress' "overarching" goal in the Telecommunications Act of 1996 ("1996 Act") is that the Commission "provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."<sup>2/</sup> In passing the

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<sup>1/</sup> By Order released June 6, 1996 (DA 96-908), the Commission extended the deadline for filing reply comments to June 12, 1996.

<sup>2/</sup> NPRM ¶ 1 (quoting the Conference Report at 113).

1996 Act the conferees agreed to give LECs "multiple entry options to promote competition, to encourage investment in new technologies and to maximize consumer choice of services that best meet their information and entertainment needs."<sup>3/</sup>

The Commission explained that it has three basic goals in this proceeding: (1) to give effect to the provisions of the 1996 Act that facilitate the development of competitive telecommunications service offerings; (2) to give effect to provisions of the 1996 Act relating to LEC entry into video distribution and programming services markets; and (3) to ensure that ratepayers pay telephone rates that are just and reasonable and that do not subsidize competitive services. NPRM ¶ 22. In pursuing the third goal, the Commission said it must balance the considerations of administrative simplicity, adaptability to evolving technologies, uniform applications among LECs; and consistency with economic principles of cost-causation. NPRM ¶ 24.

As it considers the various conflicting arguments regarding appropriate allocators, cost projections and network usage set forth in the comments filed in this proceeding, the Commission must stay focused on the goals set by Congress: to promote competition in the video services market; to encourage investment in new technologies; and to maximize consumer choice of services. Any cost allocation rules that hamper rather than foster the

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<sup>3/</sup> NPRM ¶ 4 (quoting Conference Report at 172).

achievement of these goals will be inconsistent with the mandates of the 1996 Act.

**II. A 75 PERCENT FIXED ALLOCATOR IS INSUPPORTABLE AND WILL HAMPER LEC ENTRY INTO THE VIDEO SERVICES MARKETPLACE**

In its Comments, PRTC demonstrated that the uniform application of the Commission's proposed 50 percent fixed allocator would make it economically infeasible for LECs to provide competitive video services over hybrid networks. Such a result is inconsistent with the goals of the 1996 Act. Moreover, the NPRM is unclear as to whether the proposed 50 percent allocator would be applied to all LECs regardless of whether they provide video services. Thus, adoption of the proposal may leave a LEC that does not provide such services without any manner by which to recover half of its loop costs incurred in providing telephone service, thus endangering the LEC's economic viability.

Some parties, however, proposed an even greater allocation (75 percent) of loop cost to video services.<sup>4/</sup> Such a large fixed allocator would clearly make LEC entry into the video services market economically prohibitive and prevent LECs from providing advanced video services over integrated networks.

**a. A 75 Percent Fixed Allocator Is Not Necessary To Protect Telephone Ratepayers**

The parties proposing a 75 percent fixed allocator claim that it is necessary to protect telephone ratepayers from cross-

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<sup>4/</sup> See, e.g., Comments of National Cable Television Association ("NCTA") at 17.

subsidizing the LECs' nonregulated activities.<sup>5/</sup> A fixed allocator of any proportion, however, and particularly a fixed allocator of 75 percent, is unnecessary to protect telephone ratepayers. Although the NPRM states that the Commission's current cost allocation rules were not designed for the task of allocating common costs between LECs' current regulated services and the nonregulated services that will be introduced,<sup>6/</sup> the comments in this proceeding point out, as the Commission itself acknowledged in its video dialtone proceeding, that its Part 64 rules were developed after an exhaustive study and were designed for exactly this situation.<sup>7/</sup>

Moreover, as competitive carriers enter the local telephone market, LECs will no longer have a "captive" base of telephone subscribers. At that point, cross-subsidization issues may become moot. In fact, if the Commission's prescribed allocation of costs to regulated services is very low, enabling LECs to lower their prices for such services, competitive carriers then may complain that the LECs' rates for such services are "predatory."

PRTC agrees with US WEST that, in any event, focusing solely on potential cross-subsidization at the expense of developing competitive markets is inconsistent with the 1996 Act and with

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<sup>5/</sup> See, e.g., NCTA at 15.

<sup>6/</sup> NPRM ¶ 2.

<sup>7/</sup> See, e.g., Comments of Sprint Corporation at 2-3; Comments of Southwestern Bell Telephone Company ("SWBT") at 3-4; GTE's Comments at 8.

the interests of the consumers. If the Commission errs too far on the side of protecting the regulated ratepayer, there likely will be nothing to cross-subsidize.<sup>8/</sup> The Commission expresses concern that telephone ratepayers be able to share in the economies of scope of an integrated network, but if the allocation of costs to new services is too high, there will be no integrated network, and no economies of scope for telephone ratepayers to enjoy.

In short, the Commission should reject the proposed 75 percent fixed allocator. Such a high allocation of costs to nonregulated services would prevent LEC provision of video services over integrated networks and is not necessary to protect telephone ratepayers from cross-subsidization.

**b. The Goals of the 1996 Act Cannot Be Sacrificed Merely For the Sake of Administrative Simplicity**

A number of parties focus on "administrative simplicity" as a major reason why the Commission should adopt a fixed allocation factor. While such a consideration is valid as long as it can be achieved consistently with the goals of the 1996 Act, those goals cannot be sacrificed merely in an attempt to obtain administrative simplicity.

Administrative simplicity is only one of the considerations that the Commission said it must balance in establishing a cost allocation system that will prevent cross-subsidization of nonregulated services with regulated service revenues. NPRM

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<sup>8/</sup> Comments of US WEST at 3.



¶ 24. Another consideration to be balanced is "consistency with economic principles of cost causation." Id.

NCTA contends that any allocator is somewhat arbitrary, and that an allocator based on cost studies and economic analyses "will not produce commensurately better decisions" than a fixed allocator. NCTA at 11. Therefore, NCTA says, "the allocator should be derived from policy goals, not from microscopic observation of the costs." NCTA at 17 n.42.

NCTA's conclusion ignores the principle recognized by the Commission that "consistency with economic principles of cost causation is the most direct means of assuring that telephone ratepayers do not bear the costs and risks of competitive, nonregulated activities." NPRM ¶ 26. Moreover, if the allocator should be "derived from policy goals" rather than cost studies, then a low percentage of costs should be allocated to nonregulated activities. This would better achieve Congress' goals of introducing competition in the video services marketplace and of providing consumers with advanced services over integrated networks. NCTA's proposed 75 percent allocator would actually hinder achievement of those goals.

Moreover, the administrative ease of applying a fixed allocator uniformly among LECs is debatable. BellSouth explains that "[a]ny reasonable application of a fixed factor would have to be performed below the study-area level and would impose heavy recordkeeping burdens, which are not now necessary."<sup>9/</sup> NYNEX

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<sup>9/</sup> Comments of BellSouth Corporation at 21-22.

insists that "[f]or fixed factors to yield meaningful results they must have some reasonable basis in fact and experience, and not be arbitrary."<sup>10/</sup> And SWBT maintains that any fixed factor chosen at this time will have to undergo review and adjustment as the true extent of LEC resources devoted to video services becomes evident: "Unless a fixed factor is established on the basis of some economic principles and reviewed continually, it would not adapt to the rapidly changing technology and communications environment."<sup>11/</sup>

If the Commission considers administrative simplicity to be of paramount importance, an alternative to cost studies and to a fixed allocator would be the revenue-based allocator proposed in PRTC's comments. Such an allocator would not involve the "microscopic observation of costs" that NCTA finds so objectionable, but it would reflect and account for the benefits actually received by the LEC in providing nonregulated services.

The latter point is crucial: if the chosen cost-allocation method does not reflect reality and overallocates costs to nonregulated services, then LECs will be discouraged from engaging in such activity. PRTC agrees with GTE that "[d]iscouraging LECs from investing in more efficient integrated

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<sup>10/</sup> NYNEX Comments at 14.

<sup>11/</sup> SWBT at 13 n.28, 15. See also Comments of Pacific Bell and Nevada Bell ("Pacific Bell") at 13.

facilities is a high price to pay for administrative simplicity."<sup>12/</sup>

**III. THE COMMISSION SHOULD NOT PRESCRIBE A FIXED ALLOCATOR ON THE BASIS OF THE MEAGER RECORD IN THIS ACCELERATED PROCEEDING**

Several parties point out that the Commission's current cost allocation rules, and the fixed allocator used in the separations process, were prescribed only after a thorough public record on the subject was compiled.<sup>13/</sup> By contrast, in this proceeding the Commission is regulating in a vacuum, and the prescription of a fixed allocator could only be based on speculation as to possible future uses of the telephone network.<sup>14/</sup>

Any fixed allocator prescribed by the Commission in this proceeding will have far-reaching effects on the ability of LECs to provide competitive nonregulated services and on the consumer's ability to receive such services. The record in this accelerated proceeding is too meager to justify prescribing a fixed allocator that will have such a substantial impact on the telecommunications market. Therefore, the Commission should not prescribe a fixed allocator on the basis of the record in this proceeding.

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<sup>12/</sup> GTE at 7.

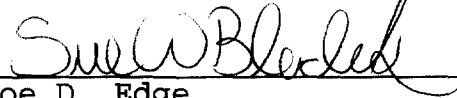
<sup>13/</sup> See, e.g., GTE at 8; NYNEX at 14; Pacific Bell at 15.

<sup>14/</sup> See US WEST at 6; NYNEX at 14-15.

**CONCLUSION**

For these reasons, the Commission should not adopt a fixed allocator for loop plant costs as proposed in its NPRM.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Sue W. Bladek", is written over a horizontal line.

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**Certificate of Service**

I hereby certify that a copy of the foregoing Reply Comments of Puerto Rico Telephone Company was sent by first-class U.S. mail, postage prepaid, on this 12th day of June, 1996, to the below-listed parties:

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